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Roland Webb v. R.O.A General, Inc., a Utah corporation, William Reagan, individually, and Douglas T. Hall, individually : Reply Brief

Utah Supreme Court

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IN THE SUPREME COURT OF THE STATE OF UTAH

ROLAND WEBB, Plaintiff-Appellant, v. R.O.A. GENERAL, INC., a Utah corporation, WILLIAM REAGAN, individually, and DOUGLAS T. HALL, individually, Defendants-Respondents.	88-0197-CA Supreme Court No. 870360 Priority No. 14b

REPLY BRIEF OF APPELLANT ROLAND WEBB

ON APPEAL FROM THE JUDGMENT
OF THE THIRD JUDICIAL DISTRICT COURT
FOR SALT LAKE COUNTY, STATE OF UTAH

HONORABLE JAMES S. SAWAYA, JUDGE

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REPLY BRIEF OF APPELLANT ROLAND WEBB

Appellant Roland Webb ("Webb") respectfully submits this brief in reply to the brief filed on behalf of Respondents R.O.A. General, Inc. ("R.O.A."), William Reagan ("Reagan") and Douglas T. Hall (collectively "Respondents").

SUMMARY OF THE CASE

The principal issue on appeal is Webb's status as a shareholder of R.O.A. for purposes of exercising his statutory right to inspect the books and records of R.O.A. By written agreement dated July 7, 1981, Webb gave R.O.A. an option to repurchase all of Webb's 20% stock interest in R.O.A. at a price to be determined by independent appraisals. (R. at 34, 62-78, 203, 274). By letter dated January 27, 1987, R.O.A. gave notice of its exercise of the option. (R. at 43, 78A, 207, 280, 484, 508). On three subsequent occasions, Webb notified R.O.A. and

Reagan, president of R.O.A., that he wished to exercise his right, pursuant to Utah Code Ann. § 16-10-47(b), to examine the books and records of R.O.A. to determine its financial condition, to verify the accuracy of its books and records, and to determine the approximate value of his stock prior to submitting it to an independent valuation. (R. at 53, 485). On each of these occasions, Webb was refused access to R.O.A.'s books and records. Respondents specifically denied Webb access to the books and records on the third occasion on the theory that the exercise of the option by R.O.A. automatically divested Webb of his status and rights as a shareholder, even though no appraisal had been performed, no purchase price had been established, no payment for the stock had been tendered and no shares had been transferred. Webb contends in this appeal that he is entitled to his statutory shareholder right of inspection and seeks an order from this Court (i) reversing the District Court's Summary Judgment denying said right, (ii) requiring R.O.A. to permit such inspection and (iii) imposing the statutory penalties against each of the Respondents.

ARGUMENTS

POINT I.

WEBB IS A SHAREHOLDER OF R.O.A. AND HAS A STATUTORY RIGHT TO INSPECT THE BOOKS AND RECORDS OF R.O.A.

Utah Code Ann. § 16-10-47(b)(1986) unambiguously provides that the right to inspect the books and records of a corporation is available to "any person who is a shareholder of record." The

Utah Supreme Court has concluded that statutory inspection rights are accorded to "shareholders of record." Goddard v. General Reduction & Chemical Co., 193 P. 1103, 1105 (1920); see also Holmes v. Bishop, 75 Utah 419, 285 P. 1011, 1012 (1930) ("One who regularly is a stockholder of record is presumed to be a bona fide stockholder."). It is undisputed in this case that Webb is, and has been throughout this litigation a shareholder of record of R.O.A.

Respondents R.O.A. and Reagan have failed in their Response Brief to distinguish any of the authorities cited by Webb, all of which hold that the mere exercise of an option to purchase a shareholder's stock does not deprive the shareholder of his shareholder status and statutory right of inspection. The authorities cited by Respondents in support of their position are clearly distinguishable from the instant case. Moreover, Respondents' arduous reliance on general contract principles is misplaced because, as demonstrated below, a direct and forthright application of general contract law clearly supports Webb's position in this appeal.

A. The cases cited by Webb are indistinguishable from the instant case.

Respondents' argument in this appeal rests entirely on the proposition that "once a shareholder enters into a binding contract of sale, title to the stock is immediately transferred from that stockholder to the purchasing corporation." Respondents' Brief at 22. Respondents assert that all of the

cases to the contrary cited by Webb are "incontrovertibly distinguishable" because they involve "executory contracts," whereas R.O.A.'s exercised option to purchase Webb's stock was not executory but rather "a binding bilateral contract of sale." Respondents' Brief at 24. Respondents, however, reveal the flaw in their own argument by stating: "While several acts, including the setting of the purchase price and the delivery of the stock, remain to be performed in the future, R.O.A. has irrevocably bound itself to purchase plaintiff's stock." Respondents' Brief at 24. Respondent's statement embodies the very definition of an executory contract, i.e., "a contract that has not as yet been fully completed or performed." Black's Law Dictionary 512 (5th ed. 1979).

Despite R.O.A.'s notice of exercise of the option to purchase Webb's stock, R.O.A.'s payment of the purchase price and Webb's transfer of the stock are concurrent conditions, neither of which has been performed. By definition, the agreement, although binding on both parties, remains executory until these conditions have been satisfied. The authorities cited by Webb expressly hold that until a stockholder has received payment for his shares or the shares have been transferred on the books of the corporation--in other words, as long as the contract remains executory--the stockholder retains his right to examine the books and records of the corporation. See Appellant's Brief, 13-18.

B. The cases relied upon by Respondents are not on point.

Respondents' admission that the only cases dealing with statutory rights of inspection cited in their brief "may not be on all fours with the instant case" is an understatement. See Respondents' Brief at 22. Each of the four cases cited by Respondents is a conclusory decision from the New York state lower court containing little or no factual or legal discussion. Each of these cases is clearly distinguishable from the instant case.

In Dierking v. Associated Book Service, Inc., 31 Misc. 2d 995, 222 N.Y.S.2d 729, 730 (N.Y. Sup. Ct. 1960), for example, the court observed that the individual who was denied access to the corporation's books and records was the defendant in an action "for specific performance compelling delivery of the certificate of stock representing the shares thus sold," implying that the stock in question had either been paid for or that the conditions for transfer of the stock had otherwise been met. Similarly in Nash v. Gay Apparel Corp., 11 Misc. 2d 768, 175 N.Y.S.2d 938, 939 (N.Y. Sup. Ct. 1958), the court observed that the complaining shareholder had sold his stock to the corporation and had already delivered the stock to an escrow agent pending final payment of the purchase price. Finally, in Rosenberg v. Steinberg-Kass, Inc., 18 Misc. 2d 880, 190 N.Y.S.2d 135, 136 (N.Y. Sup. Ct. 1959), the court concluded that the shareholder's rights had been terminated since "the purchase price of the stock was paid in full," and the shareholder had acknowledged in writing that he had delivered his stock certificates to the corporation.

Respondents place particular emphasis on the decision in In re Gaines, 4 Misc. 2d 935, 180 N.Y.S. 191 (1919), aff'd 190 App. Div. 941, 179 N.Y.S. 922 (1920), which they erroneously claim was based on facts similar to those in the instant case. In contrast to the instant case, the individual who was denied the right of inspection in Gaines, had already endorsed the stock certificates and delivered them to an escrow agent to whom payment for the shares had also been tendered by the company. The Gaines court concluded that "the action of petitioner in indorsing the stock in blank and delivering the same to the Banker's Trust Company in itself divested petitioner of title." Id. at 192 (emphasis added).

The instant case is controlled by the cases cited by Webb in his original brief, each of which is squarely on point. Webb's shares have never been appraised, paid for, endorsed or transferred on the corporate records as required to complete the transfer of title. Consistent with each of the cases cited by Webb in his original brief, Webb retains his shareholder status and right to examine R.O.A.'s books and records pending satisfaction of those conditions. In fact, the courts have stressed that a shareholder's right to inspect the corporation's books and records is particularly important upon execution of a contract to sell his shares since the shareholder is entitled to verify the adequacy of the price paid for his shares. Estate of Bishop v. Antilles Enterprises, Inc., 252 F.2d 498, 499 (3rd Cir. 1958)(until the shares are paid for, the shareholder "has a very

real interest in securing accurate information as to the state of the . . . corporation's accounts.")

C. General contract principles are not controlling in this case.

Respondents' argument that the exercise of an option to purchase stock creates a valid and binding bilateral obligation on the part of both parties merely recites general hornbook law and Webb has never argued otherwise. Respondents fail to acknowledge, however, that a bilateral contract remains executory until each party has performed its obligations thereunder. The obvious fact that the R.O.A./Webb option agreement is a bilateral contract does not support the conclusion Respondents draw therefrom that "[u]pon exercise of the option, title passes" and Webb "ceased to be a shareholder in R.O.A." on the date the notice of exercise was given. See Respondent's Brief at 10-11.

Respondents' contention that "payment is irrelevant" to the issue of Webb's shareholder status (Respondents' Brief at 13) is not supported by the authority Respondents cite in their brief. Respondents quote Fletcher Cyclopedia of the Law of Corporations § 5628 for the proposition that "passing of title is not predicated upon payment of the purchase price." Respondents' Brief at 13. A footnote reference to the language quoted by Respondents, however, explains that full payment of the purchase price under an installment note is not necessary to the passing of title. 12A Fletcher Cyc. Corp. § 5628 n.14 rev. perm. ed.

1984)(referring reader to § 5613). Fletcher further explains at § 5613:

> If the contract indicates that it is the intent of the parties that title to the stock and the rights of a stockholder shall not pass until some future time, it is construed to be an executory contract for the purchase and sale of the stock. So if by the terms of the contract the buyer is bound to do anything as a consideration, either precedent or concurrent, on which the passing of the property depends, the property will not pass until the condition is fulfilled, even though the certificate may be delivered.

Id. § 5613 (rev. perm. ed. 1984).

In the instant case, payment for and delivery of the stock are clearly concurrent conditions to the passing of title, neither of which conditions has been satisfied. The decisions of Tracy v. Perkins-Tracy Printing Co., 278 Minn. 159, 153 N.W.2d 241 (1967) and Currey v. Willard Stream Service, 321 P.2d 680 (Okla. 1958), cited in Respondents' brief, each involved a stock purchaser's failure to make payments under an installment obligation and stand solely for the proposition that full payment under an installment contract is not required to pass title.

With respect to Respondents' contention that delivery of the actual stock certificate is not necessary to pass title (Respondents' Brief at 14), Respondents have acknowledged, to their detriment, that this rule applies only when "the purchase has been completed." Respondents' Brief at 15 (citing 11 Fletcher Cyc. Corp. § 5094 (rev. perm. ed. 1986)(emphasis by respondents)). Owyhee, Inc. v. Robbins Marco Polo, 17 Utah 2d 181, 407 P.2d 565 (1965), and Davies v. Semloh Hotel, 86 Utah 2d 318, 44 P.2d 689 (1935), cited by Respondents in support of their argument, simply

hold that when all necessary conditions to the sale of stock have been completed, title and rights to the stock are not necessarily determined by possession of the certificates.

Applying the very standards and reasoning of the cases cited by Respondents, the purchase of Webb's stock has never been completed. The option agreement between Webb and R.O.A., by its terms, contemplates a consummated sale only after the stock has been appraised, payment of the purchase price has been tendered and the stock has been endorsed and transferred.

Taylor v. Daynes, 118 Utah 2d 72, 218 P.2d 1069 (1950), is distinguishable from the instant case because the stock purchase contract in that case was "not executory, but [was] a contract of a present purchase and sale." Moreover, the stock certificates had already been delivered and accepted once. The court observed:

> A contract to sell implies that the title in the goods remains vested in the seller and is to be transferred to the buyer at some future time. Whether a contract is one of sale or an executory contract to sell depends always upon what the parties to it intend in regard to the time when title in the property is to go to the buyer.

Id. at 1072. Respondents cannot argue in good faith that either Webb or R.O.A. intended title to pass immediately upon exercise of the option. Both parties knew that an appraisal would have to be conducted and that the purchase price would have to be paid before title to the shares would pass. It is undisputed that prior to Respondents' third refusal to allow Webb to inspect R.O.A.'s books and records, R.O.A. recognized Webb as the owner of his shares. For example, in March 1987, at least two months after the option

was exercised, R.O.A. asked Webb to pledge his stock to First Security Bank as collateral for a $10,000,000 loan to R.O.A. See Appellant's Brief at 13; R. at 484.

Respondents further allege that Webb has somehow breached the stock option agreement by failing to deliver his shares to R.O.A. However, they do not cite any provision of the agreement or any facts in the record supporting their claim of breach. See Respondents' Brief at 12-13. Respondents' argument based on Calderia v. Sokei, 49 Hawaii 314, 417 P.2d 823 (1966), that a party to a contract may not use his breach as a basis for an action to enforce the contract or as a defense against such an action is entirely inapplicable in this case. Not only is the record devoid of any facts indicating that Webb breached the option agreement, Webb is not seeking to enforce or resist enforcement of the option agreement, rather he is seeking to enforce his statutory right of inspection.

POINT II.

WEBB DID NOT CONTRACT AWAY HIS STATUTORY RIGHT TO INSPECT THE BOOKS AND RECORDS OF R.O.A.

Respondents contend for the first time on appeal that Webb somehow waived his rights as a shareholder of record under Section 16-10-47(b) by agreeing, in 1981, to submit to an independent appraisal to determine the value of his stock if and when the stock was ever sold. This argument simply cannot be made in good faith in view of Section 16 of the Agreement which states, "The Stockholders shall retain all their rights as stockholders of the Corporation, except those specifically modified by this

Agreement." R. at 75. The Agreement contains no specific waiver by Webb of his statutory right of inspection. In fact, Respondents' argument is inconsistent with the position R.O.A. took in 1985 when it permitted Webb to conduct a shareholder inspection. The broad inspection rights granted by the Utah Legislature do not "serve the same purpose" as appraisal rights. See Respondents' Brief at 23.

POINT III.

WEBB'S DEMANDS FOR INSPECTION WERE FOR A PROPER PURPOSE.

Once a shareholder has alleged a proper purpose, it is the duty of the corporation to put forth specific facts demonstrating an improper purpose. Goddard v. General Reduction & Chemical Co., 57 Utah 180, 193 P. 1103, 1107 (1920). This burden is not satisfied by general accusations of harassment and vexation. In Holmes v. Bishop, the Utah Supreme Court summarized:

> In the answer it also was alleged that the plaintiff sought the inspection "For the purpose of harassing and annoying the defendants as officers of the said Intermountain Mortuary Company and to hinder them in the performance of their duties as such and to bring them and the said company into disrepute with the stockholders of said company and with the public." All that is a mere conclusion without any alleged facts to support it.

15 Utah 419, 285 P. 1011, 1014 (1930). "It is the [corporation's] burden to show bad faith and improper purpose on the part of the [shareholder]." Curkendall v. United Federation of Correction Officers, Inc., 107 A.D.2d 935, 483 N.Y.S. 2d 872, 874 (1985). Aside from bald accusations of harassment, Respondents have

introduced no evidence whatsoever of an improper purpose for Webb's examination.

Respondents' assertion that Webb conducted an inspection of the books of R.O.A. more than two years prior to his demand on April 20, 1987, is unavailing. See Respondents' Brief at 25. There is no requirement in the statute that a shareholder wait more than two years between inspections. In fact, the lapse of two years since Webb's only prior inspection suggests that Webb is not harassing R.O.A. with repeated inspections. In Holmes v. Bishop, 75 Utah 419, 285 P. 1011, 1014 (1930), a corporation denied a shareholder's right of inspection on February 19, 1929, based on the fact that the shareholder had inspected the company's books on December 13, 1928, and "on several occasions thereafter." The Utah Supreme Court concluded: "That the plaintiff had been given the privilege of an inspection in December, 1928, and on several occasions thereafter, did not justify the defendants in refusing a further inspection in February, 1929." Id.

Prior access to books and records as a director of R.O.A. is also irrelevant in determining whether Webb's present demand was for a proper purpose. Neither the statute nor any case law treats a director/shareholder differently than other shareholders.

Respondents' contention that Webb's failure to inspect R.O.A.'s records prior to R.O.A.'s exercise of the option "suggests strongly that [Webb's] demands are meant solely to vex and harass the defendants" is ludicrous. The cases of delay cited by Respondents in support of this argument are furthermore

inapposite. Both Foss v. Peoples Gas Light and Coal Co., 241 Ill. 238, 89 N.E. 351 (1909) and Skouras v. Admiralty Enterprises, Inc., 386 A.2d 674 (Del. Ch. 1978) deal with the equitable defense of laches which has never been pleaded by Respondents. In Foss, the 1909 Illinois Supreme Court denied inspection to a shareholder who had known about mismanagement for almost 48 years but never took any action against the company. Id. at 355. Similarly, in Skouras, a former director waited nearly ten years after his resignation to remedy mismanagement which he had suspected during his term as director. Id. at 682. These cases are not applicable to the present situation in which Webb seeks to determine the present state of R.O.A.'s books and records.

Respondents' repeated attempts throughout this litigation to characterize Webb's statutory right of inspection as duplicative of his right to have an independent valuation of his stock demonstrates, at the very least, Respondents' misunderstanding of one or both of these processes. The sole purpose of the appraisal is to value Webb's stock. The purpose of Webb's statutory inspection, however, is to determine the accuracy of R.O.A.'s books and records and the legitimacy of all corporate transactions prior to submitting to, and as a safeguard in assuring the fairness and accuracy of, the independent appraisal. Considering that a substantial portion of Webb's life's work has been invested in his R.O.A. stock, it is certainly reasonable that Webb be able to exercise his statutory right to verify that the valuation of his stock is based on honest and accurate information.

Furthermore, given Respondents' repeated implications in this case that Webb's stock is in fact worthless, notwithstanding the fact that R.O.A. obtained a $10,000,000 loan from First Security Bank secured by Webb's and Reagan's stock, it is certainly a reasonable and proper purpose for Webb to review the financial records of R.O.A. to determine how the business has been conducted and whether the appraisal is based on complete and accurate information. Indeed, Respondents' repeated refusals to permit inspection lend credence to Webb's suspicions regarding the accuracy and integrity of R.O.A.'s records.

Respondents' contentions that Webb has refused to sign a confidentiality agreement and that Webb has previously usurped a corporate opportunity (Respondents' Brief at 28) have no factual foundation in the record whatsoever. The confidentiality agreement referred to by Respondents was presented only to the independent appraisers for signature after Webb had already been denied access to the books and records as a shareholder. As stated by counsel for Respondents in oral argument in the summary judgment proceedings below: "We will let them look at the books on an appraisal basis that is going to require a secrecy agreement." R. at 468 (emphasis added). Webb was never asked to sign a confidentiality agreement in connection with his requested shareholder examinations. There are no facts in the record, including those parts of the record cited by Respondents, that even remotely indicate that Webb usurped a corporate opportunity or ever misused information obtained through a prior shareholder

inspection. Respondents failed to introduce any evidence supporting these claims in the summary judgment proceedings below and it is improper for them to raise these arguments in an attempt to create a factual dispute on appeal.

POINT IV.

WEBB'S REQUESTS FOR INSPECTION WERE FOR A REASONABLE TIME.

The first time Webb sought to inspect R.O.A.'s books and records, Webb gave R.O.A. more than a month's written notice and requested that the inspection occur during regular business hours on the premises of R.O.A. Webb honored R.O.A.'s request that the requested examination be postponed until William Reagan, president of R.O.A., returned from an overseas trip. The second request was also for regular business hours on the premises of R.O.A. The second request was denied. In his third request, Webb permitted Respondents to choose the time and place and was requested by R.O.A. to appear on a specific date at a specific time. Upon arriving at R.O.A.'s corporate offices at the appointed time, Webb was again refused access. These facts are undisputed by Respondents. It is difficult to imagine a situation in which a shareholder's requests were more reasonable than those in the present case. Contrary to Respondents' assertion that Webb "made no effort to arrange a mutually convenient time to conduct the investigation," Webb made every effort to accommodate Respondents' needs even though he was not required to do so under the statute. See Respondents' Brief at 5.

Respondents have cited no specific facts which would show that the inspections would in anyway interfere with R.O.A.'s operations. Respondents have not and cannot cite to any evidence in the record supporting their conclusion that "the record clearly indicates that the defendants tried to assist the plaintiff in his attempt to review the books and records of R.O.A." Respondents' Brief at 25.

Respondents argue that it is permissible to limit the scope of inspection to avoid abuse. As an example of a case in which the court "severely limited" inspection, Respondents cite Schwartzman v. Schwartzman Packing Co., 99 N.M. 436, 659 P.2d 888 (1983). There the New Mexico Supreme Court held that the trial court did not abuse its discretion in limiting inspection to "regular business hours in addition to the 222 hours examination which had previously been allowed." Webb would be happy to have his inspection so restricted.

The material facts in this case showing adequate notice, lack of inconvenience to R.O.A. and reasonable purpose are all undisputed. Webb's request to verify the accuracy of R.O.A.'s books is, as a matter of law, a proper purpose. Business hours are, as a matter of law, a reasonable time for inspection. Clawson v. Clayton, 33 Utah 266, 93 P. 729 (1908). Both parties have made identical statements regarding the dates and the actions taken. Although Respondents have alleged an improper motive on Webb's part, they have shown no specific evidence whatsoever to

support that allegation. To remand these facts to the trial court would only add unnecessary expense and delay to both parties.

POINT V.

WEBB IS ENTITLED TO THE AWARD OF THREE STATUTORY PENALTIES AND ATTORNEYS' FEES.

The penalty provisions of the statute must serve as a viable deterrent to corporations and their officers. To permit violating parties to escape with a single penalty regardless of how many times and for how long they refuse to permit inspection effectively allows the corporation to purchase multiple and serial exemptions from the law for a one-time fee. In the case of minority shareholders, a single 10% penalty would normally be a very small price to pay to silence opposition.

Meyer v. Ford Industries, Inc., 272 Or. 531, 538 P.2d 353 (1975), cited by both Webb and Respondents, authorizes multiple penalties for multiple refusals. This conclusion does not require a liberal interpretation of the statute, only a literal one. The well-known principle asserted by Respondents, that penal statutes should be strictly interpreted, applies only when the statute is subject to different reasonable interpretations. Given the undisputed fact that three separate refusals occurred, the statute demands that three separate penalties be imposed.

CONCLUSION

The literal application of Utah Code Ann. § 16-10-47(b) and the authorities cited by Webb in his original brief, all of which are directly on point, compel the conclusion that the District Court erred in ruling that Webb's status and rights as a

shareholder were extinguished by R.O.A.'s mere giving notice of exercise of option to purchase his stock. Respondents have failed to cite any cases on point in support of their argument to the contrary. The general contract principles relied upon by Respondents in their brief are patently misapplied in this case.

Webb respectfully requests the Utah Supreme Court to reverse the District Court's order and to enter an order directing the District Court to grant Webb's motion for partial summary judgment (i) issuing an injunction pursuant to Rule 65A(a) and (e) of the Utah Rules of Civil Procedure requiring R.O.A. to make its books and records available to Webb for shareholder examination; (ii) imposing the statutory penalties in amounts to be determined at trial for each past refusal to allow such examination; and (iii) granting such other and further relief as this Court may deem necessary and proper.

Respectfully submitted this 18 day of March, 1988.

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CERTIFICATE OF MAILING

I hereby certify that I caused to be mailed a true and correct copy of the foregoing Appellant's Reply Brief in the above referenced matter this 18 day of March, 1988, by mailing the same, postage prepaid, addressed to the following:

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